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# AIRCRAFT EQUIPMENT SETTLEMENT LEASES ACT OF 1993

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GOVT.  
DEPOSITORY  
AUG 19 1993

## HEARING

BEFORE THE **HAMPDEN LAW LIBRARY**  
SUBCOMMITTEE ON  
ECONOMIC AND COMMERCIAL LAW  
OF THE  
COMMITTEE ON THE JUDICIARY  
HOUSE OF REPRESENTATIVES  
ONE HUNDRED THIRD CONGRESS

FIRST SESSION

ON

**H.R. 1140**

TO PROVIDE FOR THE TREATMENT OF CERTAIN AIRCRAFT EQUIPMENT  
SETTLEMENT LEASES

MARCH 10, 1993

**Serial No. 2**



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# AIRCRAFT EQUIPMENT SETTLEMENT LEASES ACT OF 1993

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WEDNESDAY, MARCH 10, 1993

HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON ECONOMIC AND COMMERCIAL LAW,  
COMMITTEE ON THE JUDICIARY,  
*Washington, DC.*

The subcommittee met, pursuant to notice, at 10:15 a.m., in room 2141, Rayburn House Office Building, Hon. Jack Brooks (chairman of the subcommittee) presiding.

Present: Representatives Jack Brooks, John Conyers, Jr., Mike Synar, Robert C. Scott, David Mann, Melvin L. Watt, Hamilton Fish, Jr., Elton Gallegly, Charles T. Canady, Bob Goodlatte, and Carlos J. Moorhead.

Subcommittee staff present: George P. Slover, assistant counsel; Perry Apelbaum, assistant counsel; Carrie Bedwell, assistant counsel; Catherine S. Cash, research assistant; Deloris L. Cole, office manager; and Suzanne Young, secretary; full committee staff present: Jonathan R. Yarowsky, general counsel; Daniel M. Freeman, counsel; and Peter J. Levinson, minority counsel.

## OPENING STATEMENT OF CHAIRMAN BROOKS

Mr. BROOKS. The subcommittee will come to order.

Today the subcommittee is considering H.R. 1140, legislation that I introduced to clarify the status of equipment settlement leases with bankruptcy by air carriers. Prior to the enactment of the 1978 code, the bankruptcy laws provided aircraft equipment leaseage with special protection in the event of an airline bankruptcy. Section 1110 of the code was intended to encourage aircraft financing activity by limiting the bankruptcy risk associated with such leases.

In passing the provision Congress knew full well the importance of air travel to Americans and the need to have enough viable competitors to withstand the rigors of the deregulation process which, sadly, by 1993 has almost decimated the industry.

Unfortunately, because of several ambiguous legal decisions the coverage of 1110 has become muddled. The resulting uncertainty threatens to disrupt the reorganization of Continental and other airlines that may be forced to seek bankruptcy protection in the future.

If the uncertainty results in these airlines being forced to liquidate, I am deeply concerned that competition could be severely impaired. The flying public, and that's all of us in this room and



over half of our constituents, could ultimately be made to pay the price in the form of higher fares, fewer choices, diminished service.

Liquidation would also subject the employees and the retirees of the airlines as well as the Pension Benefit Guaranty Corporation to severe economic dislocation.

Now H.R. 1140 responds to these problems by clarifying the application of section 1110 of the code. Under the simple modification proposed, a leasing arrangement which the parties agree to treat as a lease will be treated as such for bankruptcy purposes. That is what the whole bill does.

This change would apply to pending and future bankruptcies, and will help struggling air carriers emerge from bankruptcy.

This subcommittee has rather wide economic jurisdiction, with antitrust and bankruptcy comprising the major subject areas. I believe that the need for legislation in this case is every bit as necessary from the competitive standpoint as it is from the bankruptcy clarification point of view.

[The bill, H.R. 1140, follows:]



103D CONGRESS  
1ST SESSION

# H. R. 1140

To provide for the treatment of certain aircraft equipment settlement leases.

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## IN THE HOUSE OF REPRESENTATIVES

FEBRUARY 25, 1993

Mr. BROOKS introduced the following bill; which was referred jointly to the Committees on the Judiciary and Education and Labor

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## A BILL

To provide for the treatment of certain aircraft equipment settlement leases.

1 *Be it enacted by the Senate and House of Representa-*  
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the "Aircraft Equipment  
5 Settlement Leases Act of 1993".

6 **SEC. 2. TREATMENT OF AIRCRAFT EQUIPMENT SETTLE-**  
7 **MENT LEASES WITH THE PENSION BENEFIT**  
8 **GUARANTY CORPORATION.**

9 In the case of any settlement of liability under title  
10 IV of the Employee Retirement Income Security Act of

1 1974 entered into by the Pension Benefit Guaranty Cor-  
2 poration and one or more other parties, if—

3 (1) such settlement was entered into before, on,  
4 or after the date of enactment of this Act,

5 (2) at least one party to such settlement was a  
6 debtor under title 11 of the United States Code, and

7 (3) an agreement that is entered into as part  
8 of such settlement provides that such agreement is  
9 to be treated as a lease,

10 then such agreement shall be treated as a lease for pur-  
11 poses of section 1110 of such title 11.

Mr. BROOKS. With this in mind, I welcome our distinguished set of witnesses. If members have any opening statements, we would be glad to include them or we will go right to the witnesses and hear them.

This morning I asked our witnesses to appear as a panel to discuss H.R. 1140. To save time, I request each of the witnesses to summarize his statement in no more than 5 minutes.

After the witnesses have completed their statements, the subcommittee will address questions to the panel. All prepared statements will be made part of the hearing record, of course.

The first witness is James B. Lockhart, the former Executive Director for the Pension Benefit Guaranty Corporation, currently the managing director for Smith, Barney, Harris, Upham & Co. in New York.

Next we welcome back to the Judiciary Committee an alumnus, Murray Drabkin, in the center, who served as counsel on bankruptcy matters from 1957 to 1965. I remember him well and I still recognize him. He says he is on the personal straight-term depreciation schedule.

[Laughter.]

Mr. BROOKS. He is now with the law firm of Hopkins & Sutter and today he appears on behalf of the National Bankruptcy Conference.

The final witness will be Scott Scherer, assistant treasurer of the Boeing Co. He testified before this committee last August during its hearing on commercial and public sector issues in bankruptcy.

Without objection, I would like to enter into the record a letter signed by Robert Reich, the Secretary of Labor, expressing support for H.R. 1140, and a statement submitted by Continental Airlines in support of the bill.

[See appendix.]

Mr. BROOKS. Mr. Lockhart, you are recognized.

#### STATEMENT OF JAMES B. LOCKHART III, FORMER EXECUTIVE DIRECTOR, PENSION BENEFIT GUARANTY CORPORATION

Mr. LOCKHART. Mr. Chairman and members of the subcommittee, I am pleased to be here to discuss PBGC and support your bill, H.R. 1140.

The views I express today are my own.

PBGC is a Government insurance corporation with the very important mission of supporting the retirement security of 41 million Americans in 67,000 pension plans.

While the vast majority of the Nation's defined benefit pension plans remain fully funded, the insurance program is facing growing problems from poorly funded pension plans of troubled companies. PBGC's deficit for the single employer program has grown over the past 3 years from \$1.1 billion to \$2.7 billion.

Underfunding and ongoing pension plans have doubled since 1990 to an estimated \$51 billion. Well over \$30 billion of the underfunding is concentrated in the plans of a relatively few firms in the steel, auto, tire, and airline industries. Financially troubled companies present a near-term risk of \$12 to \$20 billion to the PBGC.

Using the estimates of those troubled companies, PBGC's latest 10-year forecast shows a pessimistic deficit range of \$16 to \$28 billion at the end of 10 years.

The financial problems are a consequence of fundamental weaknesses in the insurance principles supporting the program. The moral hazards of inadequate minimum funding rules, liberal guarantees, low premiums for underfunded plans, and low recoveries in bankruptcy encouraged financially weak companies to underfund their pension plans.

Legislative reforms were introduced over the last several years to address these hazards. In particular, there were important proposals to change the Bankruptcy Code to clarify that pensions and PBGC has some priorities in bankruptcy. These priorities, which appear in ERISA, the law that set us up, and the Tax Code are critical to reducing PBGC's losses and making sure that creditors take pension underfunding seriously.

It should be remembered the recoveries are shared by the PBGC with the participants that have nonguaranteed benefits. I urge you to consider these bankruptcy reforms as well as the proposals put forward by Congressman Pickle.

Another reform that would be helpful is that addressed by the Aircraft Equipment and Settlement Leases Act. Last year I wrote you in support of a similar proposal. Last fall PBGC and Continental Airlines obtained initial court approval of a settlement that resolved Continental's liability for the pension plans of Eastern Airlines. Because Continental was a member of the same control group that included Eastern Airlines, PBGC asserted claims against Continental for \$700 million that existed when the Eastern pension plans were terminated in 1990.

The settlement provides approximately \$100 million recovery for the PBGC. This recovery will not only benefit PBGC but again I emphasize that the participants with nonguaranteed benefits.

The terms of the Continental PBGC settlement are a key part of Continental's proposed plan of reorganization which awaits approval in the bankruptcy court.

The bill before you today would resolve the remaining obstacle that stands in the way of the approval of this settlement. This bill would ensure that certain arrangements entered into by the PBGC and an airline would be treated as leases under section 1110 of the Bankruptcy Code if all the parties to the agreement concur.

To reach a settlement Continental agreed to give PBGC an equity interest in 15 aircraft, which will be leased back to Continental. The existing lenders will agree to this arrangement, however, only if their interests continue to be protected by section 1110, which protects lenders and lessors by allowing them to foreclose upon leased or encumbered aircraft.

Section 1110 protection is important to PBGC and the lenders because it means that if the airline files for bankruptcy again they will be able to protect their interest in leased aircraft.

The complex settlement between the PBGC and Continental covering the largest claim in the bankruptcy is at risk because it is unclear whether the leasing arrangement in the settlement is covered by section 1110 of the Bankruptcy Code. Because the PBGC has required a minimum price guarantee when the aircraft are

sold, that may lead to the conclusion that the arrangement is a debt obligation rather than a lease covered by section 1110.

Continental's other lenders may not agree to the settlement because of this uncertainty.

Section 1110 needs to be clarified in order to remove the final obstacle to a fair and reasonable settlement between Continental and PBGC. H.R. 1140 will allow PBGC to receive the protection of section 1110 in the Continental and potentially other airline bankruptcies.

Mr. Chairman, I commend you for introducing this bill and I urge the committee to act promptly to approve this important legislation.

Thank you.

Mr. BROOKS. Thank you, Counselor.

[The prepared statement of Mr. Lockhart follows:]



Testimony of James B. Lockhart III  
Former Executive Director  
of the  
Pension Benefit Guaranty Corporation  
before the  
House Committee on the Judiciary  
Economic and Commercial Law Subcommittee  
March 10, 1993

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here to discuss the PBGC and support your bill, H.R. 1140. I was the Executive Director of the Pension Benefit Guaranty Corporation from 1989 until January of this year. I am now a managing director at Smith Barney.

PBGC is a government insurance corporation with the very important mission of supporting the retirement security of 41 million Americans in 67,000 pension plans.

While a vast majority of the nation's defined benefit pension plans remain well-funded, the insurance program is facing growing problems from poorly-funded pension plans of troubled companies. In 1990 and 1991 losses reached a billion dollars and in 1992 they exceeded \$800 million. PBGC's deficit for the single-employer program has grown over the past three years from \$1.1 billion to \$2.7 billion.

Underfunding in ongoing pension plans has doubled since 1990 to an estimated \$51 billion. Well over \$30 billion of the unfunded liabilities is concentrated in the plans of relatively few firms, in the steel, auto, tire, and airline industries. Financially troubled companies present a near-term risk of about \$12 to \$20 billion. Our future rests on these companies and a handful of companies that are not now troubled.

Using the estimates of these troubled companies, PBGC's latest 10-year forecast shows a pessimistic deficit range of \$16 to \$28 billion. It shows the large uncertainties PBGC faces, as does OMB's forecast of net claims of \$25 to \$45 billion over the next 30 years.

The financial problems are a consequence of fundamental weaknesses in the insurance principles supporting the program. The "moral hazards" of inadequate minimum funding rules, liberal guarantees, low premiums for underfunded plans, and low recoveries in bankruptcy encourage financially weak companies to underfund their pension plans.

As you know, legislative reforms were introduced over the last several years to address these hazards. In particular, there were important proposals to change the bankruptcy code to clarify that pensions and PBGC have some priorities in bankruptcy. These priorities, which appear in ERISA and the tax code, are critical to reducing PBGC's losses and making creditors take pension underfunding more seriously. It should be remembered that recoveries are shared by

the PBGC with participants that have non-guaranteed benefits. I urge you to consider these bankruptcy reforms as well as those proposed by Congressman Pickle.

One reform that would be helpful to the PBGC in the Continental and perhaps other cases is that addressed by the "Aircraft Equipment Settlement Leases Act." Last year I wrote you in support of a similar proposal.

Last Fall, PBGC and Continental Airlines obtained initial court approval of a settlement that resolved Continental's liability for the pension plans of Eastern Airlines. As you know, because Continental was a member of the same controlled group that included Eastern Airlines, PBGC asserted claims against Continental for the \$700 million in underfunding that existed when the Eastern pension plans were terminated in 1990. The settlement reached with Continental last Fall provides approximately an \$100 million recovery for PBGC. This recovery will benefit the PBGC and the participants with non-guaranteed benefits.

The terms of the Continental-PBGC settlement have been included as part of Continental's proposed plan of reorganization, which awaits approval in the bankruptcy court. The bill before you today would resolve the remaining obstacle that stands in the way of approval of this settlement. This bill would ensure that certain arrangements entered into by PBGC and an airline would be treated as leases under Section 1110 of the bankruptcy code if all the parties to the agreement concur.

In reaching a settlement with Continental, the PBGC required assurance that the payments agreed to by Continental would actually be made. In response, Continental agreed to give the PBGC an equity interest in 15 aircraft, which will be leased back to the airline. The existing lenders will agree to this arrangement, however, only if their interests continue to be protected by Section 1110. Section 1110 protects lenders and lessors by allowing them to foreclose upon leased or encumbered aircrafts. From the point of view of PBGC, as well as Continental's existing lenders, Section 1110 protection is important because it means that if the current plan of reorganization fails and the airline files for bankruptcy again, they will be able to protect their interests in the leased aircraft.

The complex settlement between the PBGC and Continental covering the largest claim in the bankruptcy is at risk because it is unclear whether the leasing arrangement in the settlement is covered by Section 1110 of the bankruptcy code. The aircraft that are covered by the settlement are subject to existing financing arrangements and these lenders are protected and want to remain protected by Section 1110. The arrangement with the PBGC may fall outside the scope of Section 1110 because the PBGC has required a minimum price guarantee when the aircraft are sold that may lead to the conclusion that the arrangement is a debt obligation rather than a lease covered by Section 1110. Because of this uncertainty, Continental's other lenders may not agree to the settlement.

The uncertainty surrounding Section 1110 needs to be clarified in order to remove the final obstacle to a fair and reasonable settlement between Continental and the PBGC. H.R. 1140 will



allow the FBGC to receive the protection of Section 1110 in the Continental bankruptcy if and when it negotiates similar settlement with other bankrupt airlines.

Mr. Chairman, I commend you for introducing this bill and urge the Subcommittee to act promptly to approve this important measure.

Mr. BROOKS. Mr. Drabkin.

**STATEMENT OF MURRAY DRABKIN, HOPKINS & SUTTER, ON  
BEHALF OF THE NATIONAL BANKRUPTCY CONFERENCE**

Mr. DRABKIN. Mr. Chairman and members of the subcommittee, it is a special pleasure for me to return to old haunts and to speak to you this morning about this legislation.

I recall, Mr. Chairman, with very great pleasure and some nostalgia my 9 years with the Judiciary Committee and with the Subcommittee on Bankruptcy and Reorganization many years ago and I recall with particular pleasure working with you, Mr. Chairman, on a considerable number of important things that we did in those days.

With respect to this particular legislation, let me try to put it in bankruptcy context, which is, I think, the role that I am supposed to be playing here today. This legislation deals with the problem of what happens in bankruptcy if somebody defaults on a lease of aircraft or aircraft equipment, or doesn't make its payments under a conditional sale contract or financing arrangement of some sort.

The general rule in bankruptcy is that the lessor or secured creditor is barred by the automatic stay from repossessing that equipment even where there is a default by the debtor without complying with certain procedural and substantive requirements. The vendor or lessor has to go in and get a lift stay. If he is a secured creditor, he has to satisfy the requirement that there is no adequate protection, or that the debtor has no equity and the property is not necessary for a reorganization.

If it's a lease, it's necessary for the lessor to go in and get the court to require the lessee to assume or reject a lease. The court can decide to give the lessee a particular amount of time in order to do that.

The net result of all of this, of course, is that it takes some time, some money, and some uncertainty as to whether and when the lessor or the conditional seller can get the property back. The purpose of that is to facilitate the reorganization plan and not strip from the debtor property which is important for reorganization.

In 1957 the then-Bankruptcy Act was amended to provide an exemption from these procedures for sellers and lessors of airline equipment. I'm familiar with the provision because I worked on that legislation as a staff member here in 1957. That provision, Mr. Chairman, was the first piece of bankruptcy legislation you let me work on.

The provision paralleled the then-existing provision for railroad equipment. What it did was to exempt secured sellers of aircraft equipment, and lessors of aircraft equipment, from the automatic stay from the restraint against their repossession.

In 1978 when the Bankruptcy Reform Act was passed, that exception was carried forward with some bells and whistles. The long and short of it is that after 60 days it's either the debtor pays or he loses the equipment. That is the basic context of what this legislation is about.

The particular provision in H.R. 1140 deals with a somewhat refined aspect of the problem. As Mr. Lockhart pointed out, the issue grows out of some language which was inserted in the 1978 legisla-

tion. The 1978 legislation contains the term "purchase money equipment."

Now, some litigants seized upon that language and said that sale leasebacks were not covered by section 1110. There was a Bankruptcy Court decision to that effect. But those matters have been cleared up, we think, by the second circuit and the third circuit decisions which make it very clear that the protection of leases under section 1110 are not limited to those that are not sale and leaseback arrangements.

This legislation would, however, we think, belt-and-suspend the situation for the benefit of the Pension Benefit Guaranty Corporation.

Now, at the outset, let me just say that as far as the National Bankruptcy Conference is concerned, the National Bankruptcy Conference has traditionally opposed legislation such as section 1110 or the similar railroad provision, section 1168, on the ground that special protection should not be given in bankruptcy based on the kinds of goods or services that are rendered.

If you're going to protect aircraft, why not protect sales of trucks, or sales of machine tools, or sales of buses? In any event, that is a philosophical position of the Conference. I suspect that Congress has long since crossed that bridge and decided as a matter of policy that it wishes to give special status to sales and leases of aircraft equipment.

If Congress wishes to do that rather than repealing section 1110, we think that it could be done in a manner which is more effective and more desirable than the way in which it is being done in H.R. 1140.

We think the trouble with H.R. 1140, as it is now written, is that it creates new uncertainties which will result, itself, in litigation. The bill, H.R. 1140, has the effect of assuring that sale leasebacks made by the PBGC are to be treated as leases for purposes of section 1110.

We have no doubt that imaginative and aggressive litigants will then seize upon that to say, "If the sale leaseback is not with PBGC, then it is not a lease because Congress just recently dealt with that, and said that it is a lease if PBGC is a party."

They would, therefore, take the view that having defined sale leasebacks for purposes of PBGC, all other such arrangements are not leases. The courts will probably come out all right after a time, but that is another siege of litigation which we don't really need in the existing morass of litigation in bankruptcy today.

Also, we remain troubled by singling out the PBGC for such treatment. Perhaps this does not rise to the dignity of a violation of the provision in the Constitution which requires uniform bankruptcy laws. But it nevertheless raises questions about evenhandedness in the treatment of similarly situated people.

Suppose you have a sale leaseback by Riggs Bank, or suppose RTC finds itself in a position where it inherits a sale leaseback of aircraft equipment. Why should they be treated any differently than the PBGC?

These observations lead the National Bankruptcy Conference to suggest that if the Congress is concerned with the PBGC's situation—and we don't really think there's that much need for concern

about it—but if it is concerned, a more effective way of dealing with the problem would be to eliminate the language in section 1110 that created all the mischief in the first place.

That is the language which talks about purchase money equipment security interests—eliminate that. If you do that, it seems to me that you will avoid creating the uncertainties that I spoke about. You would avoid having to enact special legislation for the purposes of the PBGC.

Thank you very much.

Mr. BROOKS. Thank you, Murray.

[The prepared statement of Mr. Drabkin follows:]

Testimony of Murray Drabkin

Committee on Legislation  
National Bankruptcy Conference

H.R. 1140  
Treatment of Certain Aircraft Equipment  
Settlement Leases

Economic and Commercial Law Subcommittee,  
Committee on the Judiciary,  
U.S. House of Representatives

March 10, 1993

Mr. Chairman, members of the Committee, on behalf of the National Bankruptcy Conference, I would like to thank you for the opportunity to appear before you today.

My name is Murray Drabkin. I am a partner in the law firm of Hopkins & Sutter. I have some thirty five years' experience in bankruptcy law, including nine years as counsel to the House Subcommittee on Bankruptcy and Reorganization during the late 1950s and early 1960s. I have been a member of the National Bankruptcy Conference for over twenty years and currently sit on its Committee on Legislation.

Before addressing the merits of H.R. 1140, I would like to give the Committee a brief introduction to the Conference.

The National Bankruptcy Conference is a non-profit, voluntary association of about 65 sitting judges, professors and practicing attorneys from all parts of the United States. Our members are selected for their demonstrated professional and technical excellence in the field of bankruptcy law. The Conference was founded in the mid-1930s to promote the improvement of the bankruptcy laws and their administration.



The Conference has been active in the legislative process ever since. It assisted and advised Congress in drafting the Chandler Act of 1938 and played a major role in the enactment of the current Bankruptcy Code in 1978. It presently is completing a detailed review of the operation of the Bankruptcy Code with a view toward suggesting needed amendments.

Turning to the subject of this hearing, I would like to express a few concerns that the Conference has concerning H.R. 1140.

As the members of the Committee are aware, the purpose of the bill is to assure that certain aircraft equipment lease transactions between the PBGC and airlines operating under the protection of Chapter 11 be treated as "leases" for the purposes of § 1110 of the Bankruptcy Code. Under that provision, lessors of aircraft equipment enjoy an exemption from the automatic stay provisions of the Code which allows them to retake possession of the leased equipment if the debtor is in default under the lease and fails to make overdue payments within a specified time. The traditional justification for § 1110 has been that without the special remedies afforded lessors by the statute, airlines would be unable to obtain adequate financing for their operations.

H.R. 1140 would employ § 1110 for a similar but much more specific purpose by assuring the PBGC, and the PBGC only, the preferred status of a "lessor" under § 1110 where the Corporation settled its ERISA-based claims against a debtor airline through aircraft sale-leaseback transactions with the airline.

At the outset, I should point out that the National Bankruptcy Conference has traditionally opposed legislation such as § 1110 and § 1168, the companion provision applicable to railroad rolling stock, on the ground that the Bankruptcy Code should not

give creditors special protection solely on the basis of the particular goods or services they have provided to the debtor.

Given the choice, the Conference would prefer to see the repeal of § 1110 and § 1168 rather than their expansion. However, if Congress concludes, as a matter of policy, that it is necessary to guarantee the benefits of § 1110 to the PBGC under sale-leasebacks and similar settlement arrangements by legislation rather than leaving it to the courts, the Conference believes that it should do so in a manner that will not create new uncertainties and spawn additional litigation. It should also do so in a manner that is not limited to the PBGC alone.

The problem with the bill's limited application is that while clarifying the status of settlement agreements with the PBGC, it would introduce uncertainty in the interpretation of § 1110 as it applies to transactions with other parties.

The question whether a specific lease transaction qualifies as a "lease" under § 1110 has been the subject of frequent dispute in the courts. This issue arises from the language of § 1110, which covers "purchase money equipment security interests" as well as "leases". Seizing on this juxtaposition, debtor airlines have argued that a lease is not a "lease" under § 1110 unless it results in the acquisition of new aircraft equipment by the airline. Thus, in the case of the sale-leaseback of aircraft already in the airline's fleet, the argument goes, the lessor cannot repossess the aircraft under § 1110. However, recent decisions of the Courts of Appeals for the Second and Third Circuits have done much to eliminate the uncertainty attending this issue.<sup>1</sup> Under those decisions, one of which involved Continental Airlines, sale-leaseback transactions

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<sup>1</sup> In re Continental Airlines, Inc., 932 F.2d 282 (3d Cir. 1991); In re Pan American Corp., 929 F.2d 109 (2d Cir.), affirming 125 B.R. 372 (S.D.N.Y. 1991).



of the type agreed to by the PBGC and Continental would qualify for § 1110 treatment provided that the agreements are true leases, that is, arrangements under which the lessor bears the economic risks of owning the leased equipment.

Against the background of recent case law, H.R. 1140, by applying only to lease transactions between the PBGC and debtor airlines, would support the inference that similar leases with other parties are not "leases" for the purpose of § 1110. Even if ultimately rejected by the courts, such an argument would likely result in increased bankruptcy litigation between debtor airlines and lessors.

A better approach would be to enact a provision which clarifies the status of all aircraft sale-leaseback transactions under § 1110 and not simply those to which the PBGC is a party. Congress could achieve this simply by eliminating the requirement that a security interest be a "purchase money equipment security interest" in order to qualify for treatment under § 1110. In this way, any creditor with a security interest in aircraft equipment, whether taken in new or existing equipment of the airline, would enjoy § 1110 protection. By deleting the language "purchase money" where it appears in § 1110, Congress would also make clear its intention that § 1110 apply to all leases of aircraft equipment, including sale-leasebacks. This approach would secure § 1110 status for the PBGC in the Continental reorganization and in similar cases while preventing the uncertainties and litigation that the current version of H.R. 1140 would cause. It would also avoid having to enact special bankruptcy legislation for the PBGC.

Mr. BROOKS. Mr. Scherer.

**STATEMENT OF SCOTT SCHERER, ASSISTANT TREASURER, THE  
BOEING CO.**

Mr. SCHERER. Thank you, Mr. Chairman.

Mr. Chairman and members of the subcommittee, my name is Scott Scherer. I'm assistant treasurer of the Boeing Co. My responsibilities at Boeing include arranging financing for our airline customers.

Today I'm representing Boeing in its capacity as a lender on certain aircraft currently on lease to Continental Airlines. As you know, I testified before this subcommittee in August of last year in support of a comprehensive amendment that would simplify and clarify section 1110 of the Bankruptcy Code.

The bill under consideration today, H.R. 1140, would resolve one of the issues which the air transport industry sought to address in those section 1110 amendments.

Briefly stated, this bill would ensure that settlement agreements entered into by the Pension Benefit Guaranty Corporation, with debtors in bankruptcy, would be treated as leases under section 1110.

As simple and straightforward as this is, section 1110, as presently in effect, does not enable such parties to achieve this result. The recent settlement between the PBGC and Continental Airlines was concluded after months of difficult and complex negotiations involving a number of divergent interests.

It's an arrangement that, among other things, provides for the transfer of certain aircraft to a trust for the benefit of the PBGC. The settlement addresses the needs of both the PBGC and Continental, and resolves hundreds of millions of dollars of claims against the Continental estate. However, these aircraft are also subject to existing financing arrangements involving a number of different lenders.

The interest of these lenders in the aircraft would be adversely affected if the agreement between PBGC and Continental is not treated as a lease for purposes of section 1110, and I might add that it is not that clear that this revised structure is a lease.

In fact, the lenders, Boeing being one of the lenders, have all essentially expressed that concern, and they want assurances that their current interests will remain intact when these arrangements are consummated. Their right to pursue such assurances is set forth in the court order that approved the terms of the settlement between the PBGC and Continental. Such assurances are necessary to avoid prolonged and costly litigation.

It's important to note that the only objective being pursued by PBGC, Continental, and these lenders is the certain application of section 1110 and the implementation of the mutually beneficial commercial agreement that has been reached. Unless the application of section 1110 and these types of arrangements is made certain, this simple objective will be unobtainable.

This bill would eliminate that uncertainty and allow the prompt resolution of the PBGC claims. In addition, it would greatly assist in resolving similar issues that may arise in any other airline bankruptcy proceedings that may occur in the future.

More generally, it seems to make good sense to encourage the settlement of these types of claims by the parties themselves rather than through litigation.

Finally, the passage of this bill would facilitate Continental's exit from bankruptcy. If this bill does not pass, it would have just the opposite effect.

In supporting this bill, I would also like to emphasize that it is only part of a larger urgently needed solution to the uncertainties that affect the operation of section 1110.

As stated in last year's testimony before this subcommittee, the certain availability of rights under section 1110 is one of the most significant factors in the decision of lenders and lessors to provide financing for our U.S. airlines. Lenders and lessors rely on these protections, and airlines obtain the improved terms, including lower pricing, that go along with these protections.

While the objective of the statute is clear, litigation in the airline bankruptcies that have occurred over the last several years has exposed weaknesses in the operation of section 1110, and this has created a lot of turmoil in structuring and negotiating deals in the marketplace. This uncertainty is a risk and this risk is a cost. Transactions are being priced higher because of this uncertainty and other deals just aren't getting done.

In view of the billions of dollars in aircraft financing requirements for our U.S. airlines, it is imperative for their recovery and vitality that we bring order and clarity to the operation of section 1110. Our air transport industry has never faced more serious challenges than those now confronting it. While these measures won't solve all the problems affecting the industry, they will solve some very important ones.

We hope that the bill under consideration today will promptly be enacted and that this subcommittee will then turn its attention to these larger and increasingly urgent problems.

Mr. Chairman and members of the subcommittee, I thank you for this opportunity to testify today, and, speaking on behalf of Boeing as well as others in our industry, we look forward to working with you in the weeks ahead.

[The prepared statement of Mr. Scherer follows:]

Testimony of Mr. Scott Scherer  
Subcommittee on Economic and Commercial Law  
Committee on the Judiciary  
March 10, 1993

Mr. Chairman and members of the Subcommittee, my name is Scott Scherer. I am an Assistant Treasurer of The Boeing Company. My responsibilities at Boeing include arranging financing for our airline customers. Today, I am representing Boeing in its capacity as a lender on certain aircraft currently on lease to Continental Airlines.

As you know, I testified before this Subcommittee in August of last year in support of a comprehensive amendment that would simplify and clarify Section 1110 of the Bankruptcy Code. The bill under consideration today would resolve one of the issues which the air transport industry sought to address in those Section 1110 amendments.

Briefly stated, this bill would ensure that settlement agreements entered into by the Pension Benefit Guaranty Corporation with debtors in bankruptcy would be treated as leases under Section 1110 if that is what the parties to such agreements intend. As simple and straightforward as this seems to be, Section 1110 as presently in effect does not enable such parties to achieve this result.

The settlement between PBGC and Continental Airlines was concluded after months of difficult and highly complex



negotiations involving a number of divergent interests. It is an arrangement that provides for the transfer of certain aircraft to a trust for the benefit of PBGC. The settlement addresses the needs of both PBGC and Continental, and resolves hundreds of millions of dollars in claims against the debtor's estate.

However, these aircraft are also subject to existing financing arrangements involving a number of different lenders. The interests of these lenders in the aircraft would be adversely affected if the agreement between PBGC and Continental is not treated as a lease for purposes of Section 1110. The lenders, therefore, want assurances that their current interests will remain intact when these arrangements are consummated, and their right to pursue such assurances is set forth in the court order that approved the terms of the settlement. Such assurances are necessary to avoid prolonged and costly litigation.

It is important to note that the only objective being pursued by PBGC, Continental and these lenders is the certain application of Section 1110 and the implementation of the mutually beneficial commercial agreement that has been reached. Unless the application of Section 1110 in these types of arrangements is made certain, this simple objective will be unobtainable.

This bill would eliminate that uncertainty and thus allow the prompt resolution of those claims. In addition, it would greatly assist in resolving similar issues that may arise in any other airline bankruptcy proceedings that may occur in the future. More generally, it seems to make good sense to encourage the settlement of these types of claims by the parties themselves rather than through litigation.

In supporting this bill, I would also like to emphasize that it is only part of a larger, urgently needed solution to the uncertainties that affect the operation of Section 1110. As stated in last year's testimony before this Subcommittee, the certain availability of rights under Section 1110 is one of the most significant factors in the decision of aircraft financiers to provide financing for our U.S. airlines. Financiers rely on these protections, and airlines obtain the improved terms, including lower pricing, that go along with these protections.

While the objective of the statute is clear, litigation in the airline bankruptcies that have occurred over the last several years has exposed weaknesses in the operation of Section 1110. This has, inevitably, created enormous turmoil in the marketplace. At the bottom line, uncertainty is a risk and risk is a cost. Some transactions are being priced higher because of this uncertainty, while other deals simply aren't getting done.

Section 1110 was originally enacted to bring greater certainty to the airlines and to the financiers that support their equipment needs. The present uncertainties frustrate the very purpose underlying Section 1110 and threaten the basis upon which airlines have for years procured the financing necessary to support their equipment needs. In view of the enormous financing requirements of our U.S. airlines, it is imperative for their recovery and vitality that we bring order and clarity to the operation of Section 1110.

Our air transportation industry has never faced more serious challenges than those now confronting it. While these measures won't solve all of the problems affecting the industry, they will solve some very important ones. We hope that the bill under consideration today will promptly be enacted and that this Subcommittee will then turn its attention to these larger and increasingly urgent problems.

Mr. Chairman, and members of the Subcommittee, I thank you for this opportunity to testify today and, speaking on behalf of Boeing as well as others in our industry, we look forward to working with you in the weeks ahead as these issues are addressed.



Mr. BROOKS. Thank you very much, gentlemen. Mr. Lockhart and Mr. Scherer, I have a question. How did the uncertain application of section 1110 of the Bankruptcy Code affect the PBGC/Continental settlement negotiations, in your judgment? Mr. Lockhart first.

Mr. LOCKHART. The whole situation of PBGC and bankruptcy is very uncertain, and it's one of the big problems we have at the moment, PBGC has at the moment, is that when we're negotiating, our priorities are so uncertain that it makes the whole settlement of the bankruptcy process very complex for many of these major bankruptcies. In many cases, PBGC is by far the largest creditor in a bankruptcy, and it's critical for the PBGC settlement before anything else can happen.

That's certainly what happened in the Continental case. Without a settlement with PBGC, Continental would not have found an equity infusion from Air Canada and it would not—it would probably not have survived. So it's critical to do a deal that would compensate PBGC for the \$700 million in claims.

We structured a very complex deal because it was the only assets available that were unencumbered. We got some cash, a little equity in the ongoing Continental, but by far the biggest recovery will be these leases, and we feel that it's critical for the PBGC to have recoveries in this and many other situations. We pushed as far as we could. This is the best we could get. We were aware of this uncertainty and we need it clarified.

Mr. BROOKS. And you felt that was the best protection you could get for the pension plan?

Mr. LOCKHART. Under the circumstances, it was the best settlement we could reach without pushing too far, yes, sir, Mr. Chairman.

Mr. BROOKS. Mr. Scherer.

Mr. SCHERER. Yes. Mr. Chairman, essentially—I'm speaking as a lender in this case—there are some 15 aircraft that are on lease to Continental Airlines, and these aircraft lenders have the benefits of 1110. By virtue of bringing PBGC into the deal, and PBGC taking the equity in the deal, and based on the way the deal has been structured between PBGC and Continental, there are certain complex aspects of the transaction which essentially blow the true lease characterization. And under section 1110, in the court cases that we have seen, true lease is critical as to whether a lease is a lease for purposes of section 1110. You know, if it's a true lease, it gets 1110; if it's not a true lease, it doesn't have 1110.

We believe that the structure as currently contemplated between PBGC and Continental is not a true lease, and hence the clear need for H.R. 1140.

Mr. BROOKS. All right.

One other question. Mr. Drabkin, on the legislative history of H.R. 1140, could it not be developed in a manner to respond to your concern that the bill could confuse the status of cases not involving PBGC settlement leases? Couldn't we handle some of that in a report and make it very clear that it's not? I think that's what we had intended. We do not intend to affect other cases.

Mr. DRABKIN. Well, you could try, but I would not be optimistic about its effectiveness. As you know, the Supreme Court, certainly so long as Justice Scalia sits, takes the—

Mr. BROOKS. But you know changes are about to be coming.

[Laughter.]

Mr. DRABKIN. Until there are five of those, Mr. Chairman, there is a very distinct possibility that the Court will look at the plain meaning of the words and not go back into legislative history to decide what a piece of legislation means. Indeed, with this piece of legislation, I wouldn't see any need to go back and look at the legislative history.

It seems to me that what a court would do would be to look at this legislation and apply the normal rules of statutory construction and say, having made a special exception for one situation, everything else comes out, and that is an old rule of statutory construction. What is it? *Exclusio unius, inclusio alterius*, or, to put it another way, look at the whole statute, and it seems to me that one could easily infer that on the face of the statute, sale leasebacks which are not to the PBGC do not get the benefit of these protections. So I think it might not be effective.

Also, Mr. Chairman, the legislative history would not deal with the other problem we have, and that is that a statute such as this ought to be of uniform applicability and it ought to be available not only to the PBGC, but to other people who have sale leasebacks.

Mr. BROOKS. Thank you very much.

The gentleman from New York, Mr. Fish.

Mr. FISH. Thank you, Mr. Chairman.

Mr. BROOKS. Do you have an opening statement and some questions? However you want to handle it.

Mr. FISH. Well, I'd like to read briefly from my statement.

Mr. BROOKS. The gentleman is recognized.

Mr. FISH. Thank you, Mr. Chairman.

As we know, this hearing focuses on legislation the chairman has introduced to provide the protections of Bankruptcy Code section 1110 for a specific airplane lease transaction. This particular transaction is part of a settlement of Pension Benefit Guaranty Corporation claims in the Continental Airlines bankruptcy case.

During consideration of major bankruptcy legislation in the 102d Congress, I pointed to the fact that the financing and leasing of transportation equipment often is unnecessarily cumbersome as a result of Bankruptcy Code uncertainties.

Members of the House and the Senate, in an informal conference in October last, agreed to include in a compromise bankruptcy reform bill language designed to clarify that the protections of code sections 1110 and 1168 apply to a variety of financing transactions and leasing arrangements.

These provisions would have discouraged litigation and reduced risks for businesses engaged in such financing and leasing. The potential savings could have proven beneficial to the traveling public.

My interest is that this committee will not lose sight of the broader need for sections 1110 and 1168 reform as we focus today on legislation designed to address a problem in a specific case.

We also need, in my view, to give attention to the impact of the bankruptcy reorganization process on airlines that have not sought

bankruptcy protection. Concerns have been expressed that the financial problems of the airline industry as a whole are exacerbated by the capacity of airlines in reorganization to force healthier carriers to make choices that are not economically viable.

We seek to facilitate the successful rehabilitation of airlines in bankruptcy without compromising the stability of airlines that are not in bankruptcy.

Finally, substantial modifications in sections 1110 and 1168 are part of a much larger bankruptcy agenda, Mr. Chairman, that I believe Congress needs to address. Our committee should give substantial attention to major bankruptcy reform legislation in the months ahead.

Now, if I could ask a couple of questions. Mr. Drabkin, a relatively small matter appears to be threatening the viability of the Continental Airlines reorganization. Whether the Nation's fifth largest airline continues to fly may well depend on whether Congress provides assurances that section 1110 protection will be available in connection with a specific transaction involving 15 airplanes.

Now, if Congress can help the reorganization process to succeed by clarifying the law applicable to this transaction, isn't there a strong public policy reason for us to do so?

MR. DRABKIN. Mr. Fish, every party to a major financial transaction wants absolute certainty. I think Congress, in considering this legislation, has to consider whether it wants to be in the position of having to pass legislation which assures certainty for every major transaction into which a Government agency enters.

There are all kinds of deals that Government agencies do which have uncertainties about them. They have the normal uncertainties of judicial interpretations, contract interpretations, and so on. Do you want to be in the position where every time any one of a myriad of Government agencies does a major deal, you're going to have to, by act of Congress, assure that it comes out the way the agency wants it come out. I think that's a fundamental legislative question you have to deal with.

Now, as respects the particular matter before the subcommittee, assuming for the moment that the concern about what effect the courts will give to the PBGC sale leaseback is of a dimension that it threatens the Continental reorganization.

Assuming that's the case, I would suggest, Mr. Fish, if you come to that conclusion, that you ought to give some consideration to dealing with the problem in the more general terms that you, yourself, alluded to earlier.

It may be that section 1110 has to be fixed up so that the threat raised by the purchase money mortgage language in the statute to all kinds of sales leasebacks is eliminated, so you recognize that section 1110 has a problem with respect to sales leasebacks, not only for the PBGC, but for anybody else who does sales leasebacks, and deal with the whole kit and caboodle at one time.

As a matter of legislative procedure or policy, it seems to me that that's preferable to doing single-purpose, single-agency legislation.

MR. FISH. Thank you.

Mr. Scherer, last year Congress, as you know, considered amendments to sections 1110 and 1168 designed to help reduce costs and



uncertainty associated with the leasing and financing of aircraft, railroad equipment, and vessels.

The pending bill, however, is very narrowly drafted. Do you agree with me that the passage of this legislation, without congressional action on broader relief, would not provide any substantial alleviation of the problems associated with leasing and financing in the transportation industry?

Mr. SCHERER. Mr. Fish, we do thank you for your support last year. Hopefully, we can be successful this year.

I guess I would characterize this as a laser beam fix. The reason for that is the timing. Continental needs to reorganize and is planning confirmation hearings very shortly. This has got to get done. We really don't have time to wait for an overall bill. Clearly we need to have an overall bill. We hope to get one and we hope that it will pass quickly.

I think the idea here is not at all to slow down our effort on an overall bill for fixing section 1110 and section 1168. At the same time, I think it's helpful to pass H.R. 1140 and get this problem behind us.

In fact, this particular fix was part of the legislation that was contemplated last year. I think basically what we're looking at here is a two-step process for timing reasons.

Mr. FISH. Thank you. This is for anybody who cares to answer.

Some people argue that the viability of relatively healthy airlines is threatened, in part, by their need to compete with airlines in the reorganization process—airlines that can cut prices because they get relief from prepetition obligations. Do you think there's any validity to this argument? Anyone?

Mr. SCHERER. That's a big question. You know the overall impact bankruptcy has had on the airline industry. I think the Boeing Co. has taken the position in some earlier testimony before the Transportation Committee that we think it's appropriate for this panel that has been created to look into that and come up with some solutions. I just don't have the answer here today.

Mr. LOCKHART. Mr. Fish, I will just try to give you my view of the situation, having dealt with the Eastern, Pan American, TWA, and the Continental bankruptcies as the largest creditor in all those bankruptcies.

My view is that the bankruptcy process in the United States is much too long and much too cumbersome. That's one of the key things that's causing this problem, is that the airlines stay in bankruptcy for so long. They are allowed to do that. That may be causing the "price wars." Maybe it's the bankruptcy process itself that should be speeded up.

Certainly I believe, and I will say it again, that the PBGC, as the major creditor in many of these bankruptcies, needs to have its position in bankruptcy clarified, which in and of itself will speed up the bankruptcy process significantly.

Mr. FISH. Thank you.

Mr. Drabkin, do you have a comment?

Mr. DRABKIN. Mr. Fish, I have no opinion on the larger economic issue you raise with respect to competition among bankrupt and nonbankrupt airlines.

I quite agree with Mr. Lockhart that we ought to try to speed up and create a more efficient bankruptcy process. To that end I would point out that the National Bankruptcy Conference has had under review the 1978 code and its operation over the past 15 years. It expects to have a report on that available, I think even this spring, suggesting various amendments which Congress may wish to consider, with the objective of speeding up and making more efficient the process.

Mr. FISH. Thank you, Mr. Drabkin.

Mr. BROOKS. Thank you, Mr. Fish.

Mr. Synar, any questions?

Mr. SYNAR. No, Mr. Chairman.

Mr. BROOKS. I might say, at this point welcome to their first subcommittee meeting several new members, among them Mr. Bobby Scott from Virginia to my right, Mr. Dave Mann from Ohio, and Mel Watt from North Carolina; and to my left, Mr. Gallegly from California, my neighbor in the back end of the Rayburn Building, Mr. Canady from Florida, and Mr. Goodlatte from Virginia.

We are delighted to have you all here and recognize you, Mr. Gallegly. Do you have any questions?

Mr. GALLEGLY. Just one quick question.

Mr. BROOKS. The gentleman is recognized.

Mr. GALLEGLY. Mr. Scherer, I think it's obvious if this legislation isn't enacted, what effects it is going to have on Boeing. But what effects on what other companies can you foresee if this legislation is enacted?

Mr. SCHERER. I'm here basically in a capacity as a lender to Continental that is affected by these aircraft. There are a number of them.

Mr. GALLEGLY. But you do, I assume, have some observations on the effects this would have on other companies? No comment?

Mr. SCHERER. What essentially this will do, I believe, is to facilitate Continental's exit from bankruptcy. To the extent that has an effect, I think it's, on balance, a positive effect. It's better to have airlines out of bankruptcy than continuing to remain in bankruptcy.

Mr. GALLEGLY. Thank you, Mr. Scherer.

I don't have anything else, Mr. Chairman.

Mr. BROOKS. Thank you very much.

Mr. Scott, any questions?

[No response.]

Mr. BROOKS. Mr. Canady.

[No response.]

Mr. BROOKS. Mr. Inglis.

[No response.]

Mr. BROOKS. Mr. Goodlatte.

Mr. GOODLATTE. Thank you, Mr. Chairman.

I would like to ask Mr. Scherer or Mr. Lockhart if they have any comments on Mr. Drabkin's observation that perhaps we're going to create new uncertainties by doing this?

Would a better approach be to clean up the entire language in section 1110 so it was clear that all leases were covered by this and not raise the question that because this specific legislation is directed only to the specific incident, that other leases then are going



to be called into question—and we're going to spawn a whole new generation of litigation as a result of this?

Mr. LOCKHART. As I understand the issue, and I have to say I'm not a lawyer, the guarantee that PBGC has suggested is the new element here that needs to be covered. And I think Mr. Scherer suggested it might not be even considered a sale leaseback because of that guarantee mechanism.

So, I think that the important thing is—and I really can't comment on the overall fix of 1110, but certainly this is needed to make sure that the PBGC is included because of this guarantee in the lease aspects of 1110.

Mr. GOODLATTE. Mr. Scherer.

Mr. SCHERER. Again, I'm not a lawyer, either, but my opinion is that I don't think it would necessarily spawn confusion. This piece doesn't go directly to amend section 1110 of the Bankruptcy Code. As I understand it, it's a piece of ERISA legislation. It just simply says that for purposes of this type of structure that the agreement would be defined as a lease under section 1110.

So, I don't see how that would potentially affect any other deals out there, although I'm not a lawyer. There may, however, be a creative bankruptcy lawyer who could come up with a way to figure that out, unfortunately.

But that's frankly why I'm a proponent of the view that look, let's get this deal done. Let's move on quickly and fix 1110 generally.

Mr. GOODLATTE. OK. Well, I certainly understand the emergency nature of this. And it concerns me, the effect on your company and on the Pension Benefit Guaranty Corporation. But I am also concerned that we often create patchwork solutions to problems that open the door to additional problems in the future.

So, I agree that we ought to come back and address that quickly, Mr. Chairman.

Thank you.

Mr. BROOKS. Thank you very much.

Mr. David Mann.

Mr. MANN. No, sir. Thank you.

Mr. BROOKS. Mr. Watt.

Mr. WATT. Thank you, Mr. Chairman.

It seems to me that if section 1110 was a good idea in the first place, this is certainly a good idea to clarify it and get it back to its original intent.

Mr. Drabkin obviously thinks that 1110 was not a good idea in the beginning, and I'm interested in getting a little more about the history of why 1110 is in place from the other two witnesses, if they can enlighten me a little bit, just for my own edification.

Mr. SCHERER. 1110 is a very critical element that aircraft lenders have been relying upon for many years. As Mr. Drabkin indicated, it originated in the railroad industry and there was a time—I can't remember when, probably back in the thirties—where the railroad industry was in big trouble, a lot of railroad bankruptcies and so forth and they were having a hard time attracting capital.

And so, what is now today section 1110 of the Bankruptcy Code deals with these same issues. What you've got here are mobile assets and a lender is going to be willing to put his money out on

the line against that particular asset on a theory that if the borrower goes bankrupt and can't make the payments on that equipment, then within 60 days he has the right to repossess his equipment and put it somewhere else. Inasmuch as it's a mobile asset, they can put it to work on another railroad, rather than have the thing sit, wasting away until the entity reorganizes.

And this is particularly critical in aircraft where you've got assets that are worth \$50 million or \$100 million apiece. They are very expensive. Carrying costs are very expensive. The maintenance costs are very expensive.

These aircraft can deteriorate very quickly if they're not properly maintained, and flown and overhauled properly.

Lenders rely on section 1110, and frankly, I think if it were to go away, you're going to lose an awful lot of capital or ability to attract capital to this market. And that's the last thing the airline industry needs at this time. They've already lost a lot of sources of capital because of the uncertainty of 1110 right now.

People who came in and did deals, did so on the belief that there was certainty there. And these court cases have basically significantly impaired that belief and as a result a lot of people have left this business. We need to bring them back.

And we need to make it clear that irrespective of what airline goes bankrupt in what jurisdiction or judicial circuit, that the judge in that circuit is going to rule the same way on every case.

Mr. WATT. Yes.

Mr. DRABKIN. Mr. Watt, you asked about why this provision came into the law. As I indicated earlier, I'm quite familiar with that.

It came into the law because in 1957, lenders who wanted to do leases or conditional sales to what were then called feeder airlines wished to have a stronger position than they would have under bankruptcy. And so, the legislation was enacted to facilitate lending for that kind of equipment.

Now, as I say, the National Bankruptcy Conference is of the view that, as an original question, it probably was not a very good idea because why treat aircraft equipment different from multimillion-dollar machine tools or from other types of equipment.

But nevertheless, that's done, and I don't think Congress is going to seriously reconsider that legislation. It's on the books and a lot of deals are out there based on it.

What I'm suggesting is that if you wish to deal with the concerns of the PBGC by being sure that sale/leasebacks are treated as leases, you're better off dealing with that across the board than just for the benefit of the PBGC, because other people have the same problem.

Mr. WATT. Thank you, Mr. Chairman.

Mr. BROOKS. Thank you very much, gentlemen, for being here.

Mr. Scott, the gentleman from Virginia.

Mr. SCOTT. Mr. Chairman, I did have a couple of questions.

Mr. BROOKS. Go ahead. The gentleman is recognized.

Mr. SCOTT. For Mr. Scherer, could you explain the effect that H.R. 1140 will have on future airline bankruptcies, particularly in terms of their ability to emerge from chapter 11?

Mr. SCHERER. Well, to answer that I think one would have to simply speculate because one really doesn't know whether there would be a situation that is analogous to the situation that Continental is in right now.

I can see there's a possibility, should another airline go bankrupt, that there would be aircraft that have equity in them which could be assigned to the PBGC to satisfy the PBGC claims.

I mean, I clearly see that as a possibility, but I can't speculate whether that would actually happen or not. That's going to depend on whether there is another bankruptcy; whether the pensions are underfunded and what kind of a deal the PBGC is able to agree to with that particular carrier.

Mr. SCOTT. One other question.

Mr. BROOKS. Mr. Lockhart, could you clarify that? Do you think that the pension plan might have a real concern about all the airlines? They have a big pension plan in all of them. I don't know what their status is. We're not trying to analyze that at this point, but—

Mr. LOCKHART. Right. Well, the PBGC is concerned about the airline industry and there are several other airlines with very large underfunded plans that are troubled. I don't want to speculate about them declaring bankruptcy.

But this will give the us, the PBGC—excuse me—another tool in rearranging and trying to come to an agreement in a bankruptcy with an airline if they occur in the future. And that's very helpful because oftentimes there are very few unencumbered assets available.

Mr. BROOKS. Mr. Scott, proceed.

Mr. SCOTT. Mr. Chairman, following up with Mr. Lockhart, could you go a little bit more into detail on the rationale for your decision to acquire and lease back the aircraft rather than some other arrangement?

Mr. LOCKHART. In an airline bankruptcy, and in fact in all bankruptcies, really, but it seems to have happened more in the airline industry, PBGC is by statute trying to recover for the underfunded pension plans that terminate. And we're trying to recover money not only for the PBGC but, I'd like to say it again, for participants in these plans; participants with nonguaranteed benefits.

So that the money we're collecting under this lease will not only go to the PBGC but it will go to people that were participants in the Eastern Airlines plans.

It's critical to have these kinds of tools available to us because there are so few assets that are not encumbered. Cash in an airline bankruptcy gets eaten up very quickly. The other assets are also very intangible. And we think it's important to have this additional tool.

Mr. BROOKS. Thank you, Mr. Scott, and thank you, gentlemen. I appreciate your contribution.

In view of some considerable confusion over the intended scope of section 1110 of the code threatening to disrupt the reorganization of bankrupt air carriers such as Continental, at least on this issue there seems to be continuity in the past and present administration about the need to clarify the issue; to keep the Pension

Benefit Guarantee Corporation, domestic airline industry afloat.  
And I look forward to future consideration of this bill.

Thank you very much, gentlemen.

[Whereupon, at 11:11 a.m., the subcommittee adjourned.]



# A P P E N D I X

## MATERIAL SUBMITTED FOR THE HEARING RECORD

U.S. DEPARTMENT OF LABOR

SECRETARY OF LABOR  
WASHINGTON, D.C.

MAR 9 1933

The Honorable Jack Brooks  
Chairman  
Committee on the Judiciary  
U.S. House of Representatives  
Washington, D.C. 20515

Dear Mr. Chairman:

I am writing to express the Administration's support for H.R. 1140, legislation which you recently introduced.

As you know, the Pension Benefit Guaranty Corporation (PBGC) negotiated a settlement of its claims against Continental Airlines for the terminated pension plans formerly sponsored by Eastern Airlines and for the ongoing, underfunded plans sponsored by Continental. That settlement agreement has been incorporated into Continental's proposed plan of reorganization. As a part of the settlement, an aircraft trust would be created for the benefit of PBGC, and the aircraft held in the trust would be leased back to Continental. Continental would guarantee a residual value of the planes at the termination of the leases, at which time PBGC would own the planes.

Lenders on the aircraft have raised concerns about treatment of these leases under Sec. 1110 of the Bankruptcy Code. While it has been generally understood that the protections provided by Sec. 1110 to lenders of aircraft equipment would apply to these leases between the proposed trust and the reorganized Continental, it is important to remove any possible uncertainty. H.R. 1140 would do that. Enactment of H.R. 1140 would assure that lenders for the aircraft held in the trust would be protected by Sec. 1110 in the event of a subsequent bankruptcy of the reorganized Continental.

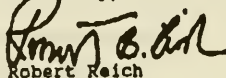
By resolving any question concerning the applicability of Sec. 1110 to the leases, your legislation would facilitate the confirmation of Continental's plan of reorganization and expedite



Continental's exit from bankruptcy. Continental's prompt emergence from bankruptcy is in the interest of all parties -- Continental, its employees, and its creditors, including PBGC.

The bill would also permit the PBGC to use this technique, if necessary, in future cases involving airlines that are in Chapter 11 reorganization. We assume, however, that the application of the bill would be limited only to aircraft and other types of property listed in section 1110. If there is any doubt about this limitation, clarifying language could be added to the bill.

Sincerely,

A handwritten signature in dark ink, appearing to read "Robert Reich", written over the typed name.

Robert Reich

cc: Honorable William Ford  
Honorable Howell Heflin  
Honorable Howard Metzenbaum  
Honorable James Jeffords

Statement of  
Gerald Laderman  
Staff Vice President for Legal Affairs,  
Financial and Aircraft programs,  
Continental Airlines  
March 10, 1993

Mr. Chairman, on behalf of Continental Airlines I wish to thank you for convening this hearing. Continental is one of the potential beneficiaries of this legislation. Regrettably, we have had severe financial problems which qualify us to benefit. This legislation will help us emerge from bankruptcy and will preserve the jobs of thousands of Continental employees throughout the United States.

The purpose of this legislation is to ensure that the PBGC obtains financial benefits in connection with the leases which will be entered into with Continental Airlines as part of the settlement resolving PBGC's claims for pension liability. These claims arose principally from Continental's former affiliation with Eastern Airlines. The magnitude of the claims could prevent, absent the settlement, the successful reorganization of Continental.

The complex settlement agreement benefits the PBGC in several ways. The structure of the settlement is derived by balancing Continental's inability to offer PBGC large, up-front cash payments with the PBGC's insistence on reasonable assurance of receiving the negotiated economic benefit. As a result, the largest portion of the consideration to be paid by Continental will involve the transfer of 15 aircraft by certain affiliates of Continental to the PBGC (a trust created for the benefit of the PBGC) subject to the

existing debt associated with the 15 aircraft. These aircraft are currently leased to Continental and would continue to be leased to Continental under the new structure. The PBGC will receive both a stream of lease payments (net of senior debt payments to be made by Continental) and guaranteed residual payments at the end of the lease term following disposition of the aircraft.

The lease transaction is premised on the continued availability of the protection afforded by Section 1110 of the Bankruptcy Code. Section 1110 generally provides that a lessor or purchase money secured lender with an interest in aircraft in the possession of an airline operating under Chapter 11 protection will not be prevented by the automatic stay from repossessing such aircraft unless the debtor airline continues to perform its obligations during the bankruptcy proceedings. The value of Section 1110 to lessors and lenders has been demonstrated time after time in the recent airlines bankruptcies. In Continental's proceedings, those lessors and lenders entitled to the benefits of Section 1110, including the lenders who have an interest in the 15 aircraft subject to the PBGC settlement, have received payments over the last two years while most other lenders have not. In the event Continental's reorganization fails and Continental again files Chapter 11, the PBGC would be able to protect its interests in the aircraft and could preserve the economic benefits of the settlement so long as Section 1110 continues to apply to the PBGC settlement leases.

The legal problem created by the settlement is easy to describe. The new leases for the 15 aircraft arguably lose the protection of Section 1110 currently available to the existing lessors/purchase money lenders. This problem arises as a result of the residual guarantee which will be provided by Continental to the PBGC. Pursuant to the settlement, Continental will be required to pay to the PBGC any shortfall between the amount realized upon sale of the aircraft at the expiration of the leases and an agreed threshold amount. Since the PBGC's full economic return is essentially being guaranteed and the PBGC will not be exposed to the residual risk normally associated with a lease, the new leases might be regarded by the courts as having debt characteristics.

There has been considerable litigation concerning the applicability of Section 1110 to lease transactions. Both the Second and Third Circuit Courts of Appeal have found that a lease must be a "true lease" and not actually a debt obligation in order to qualify for Section 1110 protection. Since the new leases under the PBGC settlement arguably have certain debt characteristics which did not exist under the original leases, both the senior lenders and the PBGC have expressed significant concern that Section 1110 protection may not be available in the future. If this issue is not resolved, the ability to complete the settlement, which is an essential piece of Continental's reorganization, will be placed in serious jeopardy.

The proposed legislation will resolve the ambiguity created by the structure of the settlement by removing all doubt that the new leases shall retain the Section 1110 protection available to the current leases. HR 1140 will give assurances to the PBGC that it will achieve the full benefit of its bargain.

Again, I want to thank the Committee for its expeditious review of this complex PBGC issue. As you know, the Bankruptcy Court is scheduled to conclude hearings on our plan of reorganization by the middle of March. Much uncertainty in the airline industry will be addressed by prompt enactment of legislation clarifying PBGC's negotiating authority.





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